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TAGS: ELAB ETRD PHUM PGOV CH
SUBJECT: Will Draft Labor Contract Law Improve Conditions for Workers?

Ref: A) Guangzhou 10741 B) Beijing 01355 C) Beijing 01153

D) 05 Beijing 10998 E) 05 Beijing 09446 F) 04 Beijing 19514

Sensitive But Unclassified; Handle Accordingly

¶1. (SBU) Summary: The draft Labor Contract Law (LCL), considered by the National People's Congress (NPC) at its March session and published for comment through April 20 by the NPC Standing Committee, gives workers increased protections by providing fixed-term contract protections for workers whose employers fail to provide a written contract, by regulating Labor Service Agencies (LSAs) that provide employers with temporary workers, and by increasing penalties for employer violations of workers rights, such as failure to pay wages, defaults by unlicensed companies and LSAs on wages, use of illegal guarantees by employers, use by employers of violence, coercion and force against workers, and abuse of authority by labor bureaus. Although the draft adds new protections for workers and gives labor bureaus stronger penalties to use to deter employer abuses, the draft cannot resolve the longstanding problems that are clearly the biggest barriers to improved working conditions in China: inadequate numbers of labor inspectors in the labor bureaus; the failure of local governments, wed to a development model premised on cheap labor and steeped in local protectionism, to enforce the law; and the unwillingness, or inability, of the central government to force lower levels of government to enforce the law. End Summary.

¶2. (U) The Labor Contract Law of the People's Republic of China (LCL), considered by the National People's Congress (NPC) during its March session and published by the Standing Committee of the NPC for a one-month comment period on March 20, has generated significant controversy. While reportedly the bulk of the more than 80,000 comments received by the NPC as of April 14 are from workers supporting the draft, employers are rallying to point out

problems with the proposed law. Laboff's analysis below is informed by review of comments published by law firms, review of submissions by companies to the NPC and by interviews with labor law professors and attorneys.

Core Change: Protection for Workers Without Contracts

¶3. (U) One of the most significant changes in the law is the inclusion of statutory protections for workers who do not have employment contracts. Draft Article 9 provides that all labor contracts shall be in writing, but also provides that where there is an actual labor relationship between an employer and employee without a labor contract, the employer and employee shall be deemed to have concluded a non-fixed term contract. Article 9 also specifies that if the employer and employee differ as to whether there is an employment relationship, the employee's view is to prevail, unless evidence to the contrary is provided. Article 10 provides that when there is no contract, the date the employee renders service to the employer is the day the employment relationship is established. (See also Paragraph 8: Penalties for Employer's Failure to Provide a Labor Contract.)

¶4. (U) Articles 9 and 10 protect workers whose employers fail to sign employment contracts with their employees, or who sign contracts that do not comply with the law. The December 2005 Report to the Standing Committee of the National People's Congress (NPC) on the Implementation of the 1994 Labor Law documented the continuing problem of employers who fail to sign contracts with their employees. Surveys and other investigations showed that fewer than 20 percent of employees in small/medium-sized non-public-owned

enterprises have signed labor contracts with their employers. The Report also identified contracts that give employers rights but employees only obligations, that provide no specifics as to employee salary, that contain provisions exonerating the company from liability for accidents, and that have not been negotiated with the employee as a continuing problem. Transasia Lawyers, an international law firm, said in its March 31 Employment Law Newsletter: "The unwillingness of many employers to sign contracts is driven by their desire to drive down labor costs. In the absence of a formal employment relationship, unscrupulous employers not only avoid having to contribute to the various mandatory social insurance schemes on behalf of their undocumented workers, but also dodge their liability to pay workers monetary compensation for early termination."

Core Change: Regulation of Labor Service Agents

¶5. (U) The draft LCL for the first time regulates Labor Service Agents (LSA; also known as Labor Dispatch Agencies). The law defines these agents as employers engaged in providing human resource services by assigning workers for employment in other companies. Article 12 of the draft LCL requires that an LSA must have registered capital of RMB 50,000 (USD 6,250), and must maintain a reserve fund of RMB 5,000 per assigned worker as a guarantee that the assigned worker will receive wages. The article also requires that the LSA have a contract with the assigned workers, which contract sets out the name of the company accepting the assigned workers, and includes the term of employment and job description, in addition to the contract terms required by Article 11. Article 12 makes the LSA responsible for supervising the company accepting the assigned workers, and for assuring their compliance with labor standards and labor conditions. LSAs are required to enter into labor force assigning contracts with the companies receiving assigned workers, and are also required to inform workers of the contents of these

agreements.

¶6. (U) Transasia Lawyers, in its March 31 newsletter, describes the problems regulation of LSAs is intended to remedy: " ... Some employers recruit through an (LSA) as a means of avoiding their lawful obligations towards staff. In some cases, an employer has dispatched its employees to an (LSA) in order for them to be seconded back to their original positions with that same employer. By changing the nature of the employment relationship, the employer is able to circumvent various obligations that it would otherwise have toward such personnel in terms of wages, benefits and other entitlements. Some employers have simply terminated employees in order to replace them with alternative staff seconded by an (LSA). Other cases involve irregular employment practices by newly established (LSAs), such as the unlawful deduction of so-called "management fees" from employees' wages and failure to pay social insurance contributions on behalf of employees. In the interests of profit, some employers turn a blind eye when (LSAs) sign contracts with employees that clearly violate employees' legal rights. For their part, some (LSAs) are unconcerned when employers fail to provide adequate safety measures for their secondees, deprive secondees of their lawful entitlement to rest periods and holidays, or violate their rights in other serious ways." (Note: See also Paragraph 7: Violations by Labor Service Agencies.) Large LSAs, such as FESCO, the Foreign Enterprise Service Corporation, reportedly contend that the capitalization requirements will be unduly burdensome.

Core Change: Increased Penalties

¶7. (U) The December 2005 Report to the Standing Committee of the NPC on the Implementation of the 1994 Labor Law notes the inadequacy of Labor Law enforcement capability by the local labor bureaus, which have insufficient employees in general, have insufficient employees and mechanisms dedicated to preventing problems, and can only handle complaints that are filed. Where complaints are filed, the Report said, the labor inspection units do not have punitive measures sufficiently powerful to deter employers. To address the latter problem, the drafters provided for significant increases in civil penalties on certain prohibited practices, and added references to criminal penalties for some prohibited practices as well.

-- Failure to Pay Wages or Other Economic Compensation: Draft Article 55 provides that if an employer fails to pay wages as required under the contract, fails to pay the minimum wage, or fails to pay other economic compensation as provided by law, the labor protection authority can order the employer to pay within a stipulated time. If the employer does not pay within that time period, the labor protection authority shall order the employer to pay the employee an additional 50 - 100 percent of the amount due. Article 55 of the draft increases by 25-75 percent current penalties on violations of the wage laws. Currently, the Rules on Economic Compensation for Violating or Terminating Labor Contracts, effective January 1, 1995 provide that for failing to pay wages in a timely fashion or for making illegal deductions from wages, the employer shall pay the unpaid portion plus an additional 25 percent of the unpaid amount (Rules, Article 3); for paying a wage below the minimum wage, the employer shall pay the insufficient portion plus an additional 25 percent of the insufficient portion (Rules, Article 4); and for not paying the employee economic compensation upon termination of a labor contract, the employer shall pay the unpaid compensation plus 50 percent of the unpaid compensation. Article 39 of the draft LCL sets a new minimum payment upon termination at 6 months of salary, and lifts the current limit on compensation (limit: 12 months of salary) in the current

Rules (Rules, Articles 5 and 7). By raising penalties, which are intended to give employers an economic incentive to obey the law, the draft addresses a series of problems identified in the December 2005 Report to the Standing Committee of the National People's Congress on the Implementation of the 1994 Labor Law. The Report stated that 12.5 percent of employees surveyed in April 2005 received wages below the local minimum wage, that 7.8 percent of employees surveyed experienced wage arrearages averaging RMB 2,184 withheld for an average of 3.2 months; in another province where the problem was particularly severe, the 16.1 percent of employees have experienced wage arrearages, the Report said.

-- Defaults by Unlicensed Companies on Wages: Draft Article 61 provides that if an entity that does not have a business license or fails to go through other procedures required by law recruits workers, the labor protection authority shall impose a fine of from RMB 1,000-5,000 (USD 125-625) per employee. The draft LCL also requires that the party awarding a contract to an unlicensed company shall be liable for the wages owed by the unlicensed company to its employees.

-- Violations by Labor Service Agencies: Draft Article 59 provides that a Labor Service Agent that violates the law shall rectify the violation upon the order of the labor authority. For "serious cases" (Note: The draft does not define "serious case." End Note) a fine of from RMB 1,000 to 5,000 (USD 125-625) shall be imposed. When an employee assigned by a Labor Service Agent has his/her rights and/or interests violated, the Labor Service Agency and the

receiving entity shall be jointly liable for compensation. If a Labor Service Agent fails to deposit a reserve fund, the labor authority shall impose a fine of from 10 to 50 percent of the reserve fund to be deposited. If the Labor Service Agency does not pay the fine, the administrative authority for industry and commerce shall cancel its business license.

-- Use by Employers of Illegal Guarantees: Article 14 of the draft LCL forbids an employer from requiring an employee to provide any guarantee, collect any money or seize the ID of the employee as security. Article 54 provides that if an employer performs any act that violates Article 14, the money or property taken as a guarantee shall be returned to the employee and a fine of from RMB 500-2,000 (USD 62.50-250) per employee shall be levied on the employer. The Article also provides that the employer must compensate the employee for any loss incurred. The current regulation governing this issue is Article 3 of the Provisions on Economic Compensation for Violating or Terminating the Labor Contract, effective January 1, 1995, which provides that the labor inspection authority may require any employer who fails to compensate an employee with overtime premium pay shall be liable for the unpaid amount plus an additional 25 percent of the remuneration.

-- Violence, Coercion, Force Against Workers: Draft Article 55 provides civil penalties of from RMB 2,000-20,000 (USD 250-2,500) on an employer who enters into a labor contract with an employee through fraud or coercion. Article 56 of the draft makes it a criminal offense to use violence, coercion or illegal restriction of personal freedom as a means to force an employee to work or to work under dangerous conditions which violate the rules and jeopardize personal safety. Furthermore, Article 56 states that the use of insults, physical punishment, beatings and illegal searches or detention of an employee shall be investigated, and if the act constitutes an offense, shall be punished pursuant to the Criminal Law.

-- Abuse of Authority by Labor Bureaus: Draft Article 62 provides that labor authorities in charge of labor

protection who exercise their authority in violation of the law, and infringe the rights of employers or employees, shall be liable for compensatory damages and for administrative penalties. In addition, such officials shall be investigated and if their acts constitute an offense, shall be punished pursuant to the criminal law.

But Draft Leaves Some Penalties Unchanged

¶8. (U) The draft leaves unchanged penalties for several practices prohibited by the Labor Law and regulations:

-- Failure by Employer to Provide a Labor Contract: The draft LCL makes no change in current penalties, set forth in the Regulation on Economic Compensation for Violating Provisions Regarding Labor Contracts in the Labor Law, effective May 1, 1995, for failure to provide a labor contract. Article 3 of the regulation provides that an employer shall compensate the employee for his/her loss in remuneration plus an additional 25 percent of the compensation for 1) intentionally failing to conclude a labor contract after hiring an employee, and for not renewing a labor contract when it expires; 2) for concluding an invalid or partially invalid labor contract; 3) for infringing the rights of a female or underage employee in violation of the regulations; or 4) for terminating the labor contract in violation of the regulations.

-- Failure by Employer to Pay Social Insurance

Contributions: Article 55 of the draft provides that if the employer fails to pay "other economic compensation," as provided by law, the labor authority can order the employer to pay within a specified time. The regulation Punitive Measures for Violating the PRC Labor Law, effective January 1, 1995, provides in Article 17 that an employer who fails to pay the Social Security contribution on behalf of the employee shall pay the unpaid contribution within the time period imposed by the labor authority plus two percent of any unpaid contribution that has not been paid within the time period imposed.

-- Forced or Uncompensated Overtime: Article 11 of the draft LCL provides that the contract shall include, among other provisions, "working hours and rest and vacations." Current regulations governing this issue are the Provisions on Economic Compensation for Violating or Terminating the Labor Contract, effective January 1, 1995. Article 3 of the regulation provides that the labor inspection authority may require the employer who fails to pay overtime premium compensation to give the employee the unpaid amount plus an additional 25 percent of the remuneration. Punitive Measures for Violating the Labor Law, a regulation effective January 1, 1995, provides in Article 4 that the labor inspection authority shall pay a fine of no more than RMB 100 per hour for forcing a worker to work extended hours without negotiating with the labor union. Article 5 of the same regulation provides for a punitive fine of not more than RMB 100 per person for three hours of overtime work per day, or over 36 hours of overtime work per month. The December 2005 Report to the Standing Committee of the NPC identifies uncompensated overtime as a common occurrence and that workers frequently work over 10 hours per day without receiving premium pay.

Could Draft Nullify Portions of Inspection Regulations?

¶9. (U) Article 45 of the draft LCL gives labor inspection authorities the right to examine and inspect materials and to inspect workplaces in connection with the conclusion of labor contracts and collective contracts, and Article 47 of the draft specifies that in carrying out inspections

officials shall enforce the law "in a civilized way." By contrast, Article 15 of the Regulation on Labor Security Inspection, effective December 1, 2004, gives labor inspectors a series of powerful tools to use in enforcing the 1994 Labor Law, including the right to enter the work site to make inspections, the right to inquire of relevant persons about the issues, the right to compel the employer to produce documents and to make statements and explanations; the right to collect information by means of photocopying, photos, video recordings and other means; the right to engage an accounting firm to audit the company's payment of wages and social insurance premiums, and other rights. It is unclear whether these provisions of the LCL, when passed by the NPC, would restrict the existing powers of inspectors, and thereby reduce, not increase, labor inspectors' ability to enforce the law.

Stricter Provisions for Employers Draw Company Complaints

¶10. (SBU) The drafters also tightened certain provisions prohibiting employer practices regarded by some as unfair to workers. The changes are opposed by some employers on the grounds that they are unduly burdensome.

-- Non-Compete Compensation and Damages for Breach: Article 16 of the draft LCL requires that where a non-compete agreement is reached, an additional agreement providing for economic compensation to the employee must also be reached. The article limits the scope of the

restriction to the territory within which the company competes, and limits the term of the restriction to two years. (Note: A 1996 notice issued by the Ministry of Labor and Social Security MOLSS) limits the non-compete period to a maximum of three years. End Note.) The Article further provides that the compensation provided to the employee shall be not less than the employee's annual wage. (Note: Jiangsu Province, Shenzhen Special Economic Zone and Tianjin Municipality all have published regulations that establish a formula for the amount of employee compensation. Jiangsu requires a payment of one third of the employee's annual wage, Shenzhen requires a payment of two thirds of annual wage, and Tianjin requires a payment of one half of the employee's annual wage. End Note.) Article 16 also provides that any damages for breach of the contract by the employee shall be not more than three times the amount paid by the employer as consideration for the non-compete agreement. Transasia Lawyers, in its March 31 newsletter, says the provisions "provide important clarifications to the current legal framework of national law, which is widely felt to be inadequate to the task of protecting the rights and interests of both employers and employees in a balanced fashion." The law firm newsletter notes that "Some employers, rather than seeking to retain key staff by offering competitive remuneration and benefits packages, attempt instead to prevent employees from leaving to join another employer midway during the term of their employment contract by insisting that they agree to an unreasonably broad and punitive breach of contract clause. Such a clause typically requires a prohibitive amount of monetary compensation from the employee in the event that they terminate the contract prematurely, and in effect, deprives the employee of their lawful right to choose alternative employment." However General Electric (GE) takes the opposite view. In comments to the NPC, the company says that this provision will force companies to make the hard choice between paying high compensation and protecting trade secrets, and recommends that the draft be amended to provide that compensation be not less than 50 percent of the annual wage of the employee. (Note: The drafters appear to be setting a ceiling while companies want to set a high floor for such compensation. End Note). GE also recommends that the cap on compensation for breach be

amended to make the employee liable for all economic damages caused by the employee's breach of the non-compete agreement.

-- Dispatched Employees: Article 40 of the draft LCL provides that the contract of an employee assigned by a Labor Service Agent (LSA, also known as a Labor Dispatch Agency) to the same company for a full two years shall be terminated and a new contract signed. GE Labor Policy Counsel argues that corporations need a flexible workforce, and should not be forced to convert temporary workers into permanent ones.

-- Probation Period: Article 13 of the draft LCL provides for probationary periods not to exceed one month for non-technical personnel, two months for technical personnel and six months for senior technical and professional personnel; the regulation also provides that the same employer can have only one probation period per employee. The December 2005 Report to the Standing Committee of the NPC notes that employers abuse probation periods. Transasia Lawyers says in its March 31 newsletter "Many employers continue to misuse the current system of probationary periods as a means of maximizing their profits to the detriment of their employees' interests. Under current regulations, if an employee can be proven not to meet the criteria for a work position during their probationary period, the employer may unilaterally terminate the employment contract with immediate effect without having to pay severance. To

exploit this system to their advantage, some employers hire employees during peak production periods, stipulating relatively long probationary periods, and then terminate the employment contract on the day before the probationary period expires." GE, on the other hand, contends that these probation periods are too short to allow an employer to judge whether an employee is qualified for the job, and suggest a probation period of six months. The company also suggests that the regulation permit one probation period for each job to allow for promotions. Under Article 21 of the current Labor Law, the allowable probation period is six months.

-- Severance Pay Upon Expiration of Labor Contracts: Article 39 of the draft LCL provides that employers shall pay compensation to an employee when the employee's labor contract expires or terminates according to its terms. Currently, Article 3 of the regulation governing Economic Compensation for Violating Stipulations Regarding Labor Contracts in the Labor Law, effective May 1, 1995, states that when an employer does not renew a labor contract when it expires, he shall be liable to compensate the employee for his/her lost remuneration plus an additional 25 percent of such remuneration. The December 2005 Report to the Standing Committee of the NPC on the Implementation of the 1994 Labor Law states that the terms of most contracts are not longer than one year, which allows employers to "circumvent" legal obligations to employees. GE argues for deletion of the provision, contending that it is inconsistent with the policy of allowing short-term contracts.

-- Effect of Merger on Labor Contracts: Draft Article 26 provides that following a merger the new employer succeeds to the contract of the merged company's employee, or, with the consent of the employee, is terminated and a new contract concluded. GE says the provision conflicts with Article 37 of the draft which provides that a labor contract terminates when an employer ceases business or is dissolved, and that the provision should be amended so that labor contracts in a merger are deemed to have the same legal effect as under Article 37.

-- Making f Company Rules: Article 5 of the draft LCL rovides that the employer shall adopt regulations and

policies having a direct relation to the vital interests of employees through discussion and approval by the trade union, workers' congress or workers' representative assembly or by equal negotiation. Article 51 provides that rules made by the unilateral decision of the employer shall be null and void. In contrast, Article 4 of the 1994 Labor law provides that employers shall establish and improve their rules and regulations according to the law and ensure that the workers enjoy their rights and perform their obligations. GE claims that making rules should be the right of the employer and that such rules should be deemed valid unless in violation of laws, regulations or collective contracts.

Will the Labor Contract Law Improve Enforcement?

¶11. (SBU) Comment: A key question is whether the LCL as drafted will improve the ability of provincial and local governments to enforce the law. New statutory protection for workers without written contracts, increased penalties with arguably stronger deterrent effect, and clear regulation of entities providing temporary workers appear to be provisions that will help provincial and local labor bureaus better protect workers. However, the draft cannot resolve the longstanding problems that are clearly the biggest barriers to improved working conditions in China: inadequate numbers of labor inspectors in the labor

bureaus; the failure of local governments, wed to a development model premised on cheap labor and steeped in local protectionism, to enforce the law; and the unwillingness, or inability, of the central government to force lower levels of government to enforce the law.

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